Statement of Rep. John J. LaFalce
Ranking Member, Committee on Financial Services
Hearing on Analyst Objectivity
June 14, 2001

Today the Subcommittee confronts the very important question of whether investors are receiving unbiased research from Wall Street securities analysts. I commend the Chairman for holding these hearings, for I am very concerned that investors have become victims of recommendations of analysts who have apparent and direct conflicts of interest relating to their investment advice.

It is clear that sell-side analysts work for firms that have business relationships with the companies they follow. Most analysts are under increased pressure to look for and attract business and to help the firm keep the business it has. The analyst is asked to be both banker and stock counselor. These two goals often live in conflict.

The individual investor is often unaware of the various economic and strategic interests that the investment bank and the analyst have that can fundamentally undermine the integrity and quality of analysts' research. The disclosure of these conflicts is often general, inconspicious and boiler-plate. In addition, current conflict disclosure rules do not even reach analysts touting various stocks on CNBC or CNN. As former Chairman of the SEC Arthur Levitt noted, " I wonder how many investors realize the professional and financial pressures many analysts face to dispense recommendations that are more in a company's interest rather than the public's interest."

I believe that it is precisely these pressures that moved many analysts during the technology boom over the last several years to recommend companies and assign valuations beyond any relationship to company fundamentals. In a recent article, a well-know technology analyst was quoted as responding to questions concerning the legitimacy of the valuation of a particular company. The analyst said, "**We have one general response to the word 'valuation' these days: 'Bull market' . . . We believe we have entered a new valuation zone**." The article to which I referred and many others make the case that these conflicts may have profoundly undermined analyst integrity, and possibly even misled investors, as analysts held fast to companies as the market eroded out from under them.

The securities industry has suggested new guidelines to address some of the conflicts we will discuss in today's hearing. This initiative is an important first step. I do not believe, however, that these voluntary guidelines go far enough to address the problem.

I am hopeful that the hearings this Thursday will begin a process whereby Congress and the regulators can begin to take a hard look at that these troubling questions affecting the American investing public. I also look forward to additional hearings where the SEC and NASD, amongst others, can testify on this question of analyst objectivity. In my view, the securities regulators' perspective is critical to the question at hand. We cannot fulfill our oversight responsibility if the government and quasi-government entities charged by Congress with the protection of investors have not been heard. Not only do the securities regulators have an important perspective on the magnitude of the problem, they also have a view on how the industry is complying with current regulations on information barriers, so-called Chinese walls, and the disclosure of conflicts.

I am increasingly concerned that industry self regulation may not be sufficient to guard against the problems and abuses we are seeing, and that more disclosure of these conflicts, in itself may not suffice to protect the individual investor. I hope today's hearing is only the first step in confronting the troubling issues of securities analysts' conflicts of interest.

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